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JUN 23 1982
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81-2409

No.

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1981

SECURITY GAS & OIL INC., a California Corporation,
RAYMOND G. MILLER, EMANUEL RAPOPORT and
JAMES BEHRENS,
Petitioners,

vs.

JOSEPH KRAMAS,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

JOHN J. MULLANE, JR., INC.
COUNSEL OF RECORD
44 Montgomery St., Suite 2218
San Francisco, CA 94104
Telephone (415) 981-8512

ROBERT G. KNECHTEL
107 Barbaree Way
Tiburon, CA 94920
Telephone (415) 383-3158
Attorneys for Petitioner

BOWNE-PERNAU WALSH • 190 NINTH ST. • S.F., CA 94103 • (415) 864-2300

QUESTIONS PRESENTED

Two questions are presented:

1. Whether the Court of Appeals erred in ruling that the Respondent's objection to the District Court's charge to the jury complied with the requirements of Fed. R. of Civil Procedure 51.

2. Whether the District Court properly instructed the jury on the elements of materiality and reliance under Rule 10b-5 issued pursuant to Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b).

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Petitioners,

vs.

JOSEPH KRAMAS,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioners respectfully pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, filed March 26, 1982.

OPINION BELOW

The Opinion of the Court of Appeals was unreported, and is set forth verbatim in Appendix "A" to this petition.

JURISDICTION

The Judgment of the Court of Appeals was filed on March 26, 1982. Jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

15 U.S.C. § 78j(b):

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

15 U.S.C. § 77q(a):

"(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make state statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Rule 10b-5 of the General Rules and Regulations of the Securities and Exchange Commission:

"Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

STATEMENT OF THE CASE

This controversy arose out of purchases of limited partnership interests in oil and gas drilling projects by Respondent Joseph Kramas (hereafter "Kramas") from the Petitioners (hereafter referred to as "SEGO"). The complaint was filed on February 3, 1977, and was later amended. The amended complaint contained claims under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and Rule 10b-5 of the General Rules and Regulations under the Securities Exchange Act; Sections 12(2) and 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a); Section 25500 of the California Corporate Securities Law; and the Common Law of the State of California for breach of fiduciary duty.

At trial the jury found for Kramas on the state law claim, but for SEGO and the individual defendants on all Federal claims.

Thereafter, Kramas appealed to the United States Court of Appeals for the Ninth Circuit, which reversed the District Court's judgment as to Kramas's Rule 10b-5 and Section 17(a) claims on the ground that the District Court erroneously charged the jury on the elements of materiality. All other issues were resolved in SEGO's favor.

In reversing the District Court's judgment, the Court of Appeals held that Kramas's objection to the jury instructions on the issues of materiality and reliance satisfied the requirements of Fed. R. Civil Procedure 51. Further, the Court ruled that the charge given by the Judge on the elements of materiality and reliance were in error. It is here urged that these rulings merit review by the United States Supreme Court.

REASONS WHY THE WRIT SHOULD BE GRANTED

1. The ruling of the Court of Appeals, and similar rulings in other Circuits, seriously undermine the spirit and intent of Fed. R. of Civil Procedure 51

The Rule provides in part:

> ". . . No party may assign as error the giving or the failure to give an instruction unless he objects thereto before the jury retires to consider its verdict, stating distinctly the matter to which he objects and the grounds of his objection. . . ."

The Court of Appeals set forth the circumstances in which this issue arose as follows:

"The trial judge began by instructing that a material fact is 'one that a reasonable person in the circumstances of the Plaintiff would attach importance to in determining his choice of action in this kind of transaction.' This means, explained the court, 'one that a reasonable person and in the plaintiff's position would deem important in deciding whether or not to purchase a limited partnership interest in an oil and gas drilling project.' R.T. 702. Kramas does not appear to contest the correctness of this formulation; indeed, the authorities he cites state the rule in the same way. *See, e.g., Marx v. Computer Sciences Corp.*, 507 F.2d 485, 489 (9th Cir. 1974).

However, the trial judge then elaborated:

> "A fact omitted to be stated is the kind of thing that a reasonable person would have changed his mind about had he known the true fact.
>
> "In the case of the matter stated, is it the sort of thing that, if stated correctly, would have dissuaded the investor from making the investment[?] R. T. 703

"At the conclusion of the court's instructions, counsel for Kramas made the following objection:

"COUNSEL: Your Honor, I would only object to the language stated by the Court concerning the reliance being that it would have dissuaded the plaintiff from investing. I didn't believe that to be the law.

"I think, as I understand the law, to be sufficient so that he would have considered it; but that the law does not say, requirement of dissuading him from investing.

"THE COURT: I think I put it in the alternative, didn't I?

"COUNSEL: I didn't understand it that way."

The appellate court ruled that although the objection was somewhat ambiguous, it was sufficient to alert the Court to error and thus satisfied Fed. R. of Civil Procedure 51, citing *Brown v. Avemco Inv. Corp.*, 603 F.2d 1367, 1372-74 (9th Cir. 1979). The Court interpreted Kramas' objection related not only to the Court's elaboration concerning the elements of materiality in matters misrepresented, but also to the Court's explanation of materiality in the case of omissions. This scenario points up the difficulty faced by trial judges when objections of this kind are not clearly presented. It is obvious that the trial judge believed the objection related only to the instruction concerning materiality in the case of misrepresentations and did not believe counsel was objecting to the instruction concerning omissions. As the matter was put to the District Judge, his conclusion was entirely reasonable. A trial court is usually at a disadvantage in not having time for contemplative reflection which is a luxury enjoyed by appellate judges. The net effect here is that Kramas now has had the opportunity to allow the case to go to the jury on an allegedly erroneous instruction, thus, hopefully, assuring himself of a second chance if he didn't like the outcome.

The Ninth Circuit, as well as other circuits, have radically departed from the spirit and intent of Rule 51. *Brown v. Avemco Inv. Corp.*, supra, is but an example of the trend in many circuits to adopt a so-called "plain error" exception to Rule 51. In effect, the Court has said that it may reverse for plain error when necessary to prevent

a miscarriage of justice despite a failure to comply with Rule 51.

Rule 51 was clearly designed to require a party to state objections to an instruction with sufficient clarity so that the trial judge may understand what they are and follow them if well taken. The Rule should prevent a party from stating one ground of objection and then relying on a different ground for the objection on appeal. See *Appleyard v. Transamerican Press, Inc.*, 539 F.2d 1026, 1031 (4th Cir. 1976), *cert. den.*, 429 U.S. 1041 (1977).

However, the Ninth Circuit, and other circuit courts, have vastly departed from the strictures of Rule 51 in allowing objections which are not stated distinctly and are not sufficiently specific to satisfy the Rule.

This Court interpreted the Rule as it should be applied in *Palmer v. Hoffman*, 318 U.S. 108, 119, 63 Sup. Ct. 477, 483, 87 Law Ed. 645 (1943):

> " . . . In fairness to the trial court and to the parties, objections to a charge must be sufficiently specific to bring into focus the precise nature of the alleged error. Where a party might have obtained a correct charge by specifically calling the attention of the trial court to the error and where part of the charge was correct, he may not through a general objection obtain a new trial. . . . That long standing rule of federal practice is applicable in this type of case as in others. That rule cannot be avoided here by reason of the requested charge. . . ."

The decision below, consequently, is in direct conflict with Rule 51 as well as the interpretation of that Rule set forth by this Court in *Palmer v. Hoffman, supra.*

2. The Court of Appeals incorrectly ruled that the trial judge's instructions to the jury on the elements of an action under Rule 10b-5 were erroneous

The instructions in question have already been quoted above. Since the instructions as to omissions were not properly objected to, as argued above, those instructions will not be addressed here. The cases cited by the Court of Appeals, *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, and *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), both treated cases involving nondisclosure of omitted facts and are inapplicable to overt misrepresentations.

The District Court's instruction that reliance must be such that an investor would have been dissuaded from making an investment in the case of misrepresentations was entirely in keeping with case law. The Ninth Circuit itself has adhered in 10b-5 cases to the traditional and less speculative common law of the objective test of materiality. In *Marx v. Computer Sciences Corp.*, 507 F.2d 485, 489, footnote 6, (9th Cir. 1974), the Ninth Circuit embraced the tenents of *List v. Fashion Park, Inc.*, 340 F.2d 457, 462 (2nd Cir. 1965), wherein the court said:

> "The basic test of 'materiality' on the other hand is whether 'a reasonable man would attach importance (to the fact misrepresented) in determining his choice of action in the transaction in question.' Restatement, Torts, § 538(2)(a); accord Prosser, Torts, §§ 554-55; 1 Harper & James, Torts, §§ 565-66. Thus to the requirement that the individual plaintiff must have *acted* upon the facts misrepresented, is added to the parallel requirement that a reasonable man would

> also have *acted* upon the fact misrepresented." [Underlining supplied].

The *List v. Fashion Park, Inc., supra*, approach to materiality is still viewed with favor in the Ninth Circuit, as well as other circuits. See *Marx v. Computer Sciences Corp., supra*. In the Second Circuit in which *List v. Fashion Park, Inc., supra*, arose, the court, in *Dopp v. Franklin National Bank*, 461 F.2d 873, 880 (2nd Cir. 1972), treated the materiality of misrepresentations as follows:

> " . . . To succeed in a 10b-5 action, the plaintiff must prove that he relied upon a misrepresentation of a material fact to his detriment. See e.g., List v. Fashion Park, Inc., 340 F.2d 457 (2nd Cir.) cert. den., 382 U.S. 811, 86 Sup. Ct. 23, 15 Law Ed. 2d 60 (1965). Thus, Dopp will have to establish that but for the misrepresentation, *he would have acted differently—in this case that he would have redeemed the shares himself or found a third party to purchase them if he had been given the opportunity.* We know, however, that as late as July Dopp had not done either." [Italics supplied.]

Clearly, the circuit courts, in the event of misrepresentations, adhere to a requirement that materiality be founded upon the concept that the investor would have acted differently had he known the true facts.

Similar reasoning was followed in *Manor Drug Stores v. Blue Chip Stamps*, 492 F.2d 136, 142 (9th Cir. 1973), (reversed on other grounds, 421 U.S. 723 (1975)), where the Ninth Circuit declared:

> "As to causation, the complaint alleges that the consent decree offer was intended to be and was a bar-

> gain; that units of securities having a market value of $315 were offered to plaintiff. Thus appellant for $101—a difference so great as to provide prima facie an *objective basis for a factual inference that users properly informed, rather than misled, would have accepted the offer. . . .*" [Underlining supplied.]

And in *Voŋs v. Dickson*, 495 F.2d 607, 622 (5th Cir. 1974), the court flatly asserted:

> "A material fact is one which would cause a reasonable investor to have acted differently in respect to a securities transaction. *Securities and Exchange Commission v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2nd Cir. 1968)."

Clearly, then, it is the law among the various circuits, including the Ninth Circuit, that in order for a misrepresentation to be deemed material, it must be established that the investor would have acted differently had the facts been truthfully stated. In the context of the instant case, this is merely another way of saying that a material fact (to paraphrase the trial court's instruction) is, "in the case of the matter stated, the sort of thing that, if correctly stated, would have dissuaded the investor from making the investment". Again, it is another way of saying that reliance on the part of the investor is a requirement under Rule 10b-5 in the case of misrepresentations.

The decision below, therefore, is directly contrary to its own authority and authority in other circuits. This Court is urged to correct this incongruity.

CONCLUSION

The writ should be granted as asked.

Respectfully submitted,

JOHN J. MULLANE, JR., INC.
COUNSEL OF RECORD
44 Montgomery St., Suite 2218
San Francisco, CA 94104
Attorney for Petitioner

(Appendix A follows)

APPENDIX A

United States Court of Appeals
for the Ninth Circuit

Joseph Kramas,
Plaintiff-Appellee,

v.

Security Gas & Oil Inc., a California Corporation,
Defendant-Appellant.

No. 78-3301
D.C. No. C 77-266 RHS

Joseph Kramas,
Plaintiff-Appellant,

v.

Security Gas & Oil Inc., a California Corporation,
Defendant-Appellee.

No. 78-3451
D.C. No. C 77-266 RHS

[Filed March 26, 1982]

Opinion
Appeal from the United States District Court
for the Northern District of California

Honorable Robert H. Schnacke, District Judge, Presiding
Argued and Submitted September 11, 1980

Before: Browning, Chief Judge, Kennedy, Circuit Judge,
and Hoffman,* District Judge

*Honorable Walter E. Hoffman, Senior Judge, United States District Court for the Eastern District of Virginia, sitting by designation.

Browning, Chief Judge:

Joseph Kramas purchased limited partnership interests in three oil and gas drilling projects in which Security Gas & Oil, Inc. (SEGO) was the general partner. Raymond Miller and Emanuel Rapoport were officers of SEGO and James Barrons was Kramas' stockbroker. Kramas purchased the partnership interests after reading prospectuses prepared by SEGO and after conversations with Miller and Barrons. The wells drilled by SEGO produced little, and Kramas lost most of his investment.

Kramas' complaint alleged that SEGO and the individual defendants violated various sections of the federal securities laws and breached their fiduciary duty to him under state law by misrepresenting certain facts and omitting to state others. The jury found for Kramas on the state law claim, but for SEGO and the individual defendants on all the federal claims. Both sides appeal.

I

Materiality and Reliance

Kramas argues that the trial judge erred in instructing the jury on the elements of an action under Rule 10b-5, issued pursuant to § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b).

The trial judge began by instructing that a material fact is "one that a reasonable person in the circumstances of the Plaintiff would attach importance to in determining his choice of action in this kind of transaction." This means, explained the court, "one that a reasonable person and in the plaintiff's position, would deem important in deciding

whether or not to purchase a limited partnership interest in an oil and gas drilling project." R.T. 702. Kramas does not appear to contest the correctness of this formulation; indeed, the authorities he cites state the rule in the same way. *See, e.g., Marx v. Computer Sciences Corp.*, 507 F.2d 485, 489 (9th Cir. 1974).

However, the trial judge then elaborated:

> A fact omitted to be stated is the kind of thing that a reasonable person would have changed his mind about had he known the true fact.
>
> In the case of the matter stated, is it the sort of thing that, if stated correctly, would have dissuaded the investor from making the investment[?]

R.T. 703.

At the conclusion of the court's instructions, counsel for Kramas made the following objection:

> Counsel: Your Honor, I would only object to the language stated by the Court concerning the reliance being that it would have dissuaded the plaintiff from investing. I didn't believe that to be the law.
>
> I think, as I understand the law, to be sufficient so that he would have considered it; but that the law does not say, requirement of dissuading him from investing.
>
> The Court: I think I put it in the alternative, didn't I?
>
> Counsel: I didn't understand it that way.

SEGO argues that the objection went only to the instructions concerning misrepresentations and not to those regarding omissions, and, as applied to misrepresentations,

the court's definition of materiality was correct. The argument is without merit.

Although Kramas' objection was somewhat ambiguous, it was sufficient to alert the court to error and thus satisfied Fed. R. Civ. P. 51. *Brown v. Avemco Inv. Corp.*, 603 F.2d 1367, 1372-74 (9th Cir. 1979). The judge's response, "I think I put it in the alternative," could only refer to one sentence in the instructions, and this sentence immediately preceded the court's erroneous instruction that the burden was on the plaintiff to show he would have acted differently had he been aware of the fact omitted.[1] The instruction was erroneous because it implied plaintiff must prove reliance upon alleged omissions by showing actual influence upon behavior. *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972), establishes that reli-

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[1]Three pages later in the transcript after the instructions on materiality quoted *supra*, the court instructed:

> While the plaintiff must establish he relied upon any false representation, it would be a little difficult to imagine how you could establish that you relied upon any failure to convey material information because you can't rely upon something that you couldn't know about.
>
> But in judging any material information that was omitted, consider that in the light of the [sic] its materiality. *Consider whether it is the kind of thing that would have been relied upon or would have been thought important had the omitted information in fact been conveyed to the purchaser.*
>
> *The burden in that case, I would think would be that the plaintiff would show that his decisions would have been different had he been made aware of the fact omitted in the presentation.* (Emphasis added.) R.T. 706-07.

ance upon alleged omissions is to be presumed from materiality.[2]

Even if the objection were directed solely to the instructions as to misrepresentations rather than omissions, the materiality instructions were wrong. The definition of materiality is the same whether misrepresentations or omissions are involved, and as the Supreme Court said in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976), this standard "does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote."[3] *See also Affiliated Ute Citizens, supra*, 406 U.S. at 153-54; *Marx, supra*, 507 F.2d at 489 & n.6.

II

Section 17(a) of the Securities Act of 1933

Kramas argues that the court erred in failing to instruct the jury that no showing of reliance was required in a

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[2]The parties and the district court assumed the holding of *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972), that when materiality has been established reliance is presumed, applied only in suits based upon omissions, and that in suits based upon misrepresentations actual reliance must be shown. We therefore decide this case on that assumption. We do not reach the question, twice reserved, of whether *Affiliated Ute Citizens* applies equally to misrepresentations. *See Keirnan v. Homeland, Inc.*, 611 F.2d 785, 788 & n.4 (9th Cir. 1980), and *Little v. First California Co.*, 532 F.2d 1302, 1304 n.4 (9th Cir. 1976).

[3]*TSC Industries* was a suit under Rule 14a-9, but the same standard of materiality applies in actions under Rule 10b-5. *Sharp v. Coopers & Lybrand*, 649 F.2d 175, 187 & n.17 (3d Cir. 1981).

private suit under § 17(a), in contrast to a private suit under Rule 10b-5 alleging misrepresentation.[4]

Kramas points to nothing in the language, history, or purpose of Rule 10b-5 and § 17(a) that would support the argument that reliance is an element of a private cause of action under one but not the other. The cases have held, or assumed, the contrary. *See Ohio v. Peterson, Lowry, Rall, Barber & Ross, et al.*, 651 F.2d 687, 689 n.1 (10th Cir. 1981); *Lanza v. Drexel & Co.*, 479 F.2d 1277, 1280 n.2 (2d Cir. 1973) (en banc); *Johns Hopkins University v. Hutton*, 488 F.2d 912, 915 (4th Cir. 1973).

The Supreme Court held in *Aaron v. SEC*, 446 U.S. 680, 701-02 (1980) that scienter is a necessary element of a violation of Rule 10b-5 and § 17(a)(1), but not of §§ 17(a)(2) or 17(a)(3). However, nothing in *Aaron* suggests a difference between Rule 10b-5 and § 17(a)(2) in respect to the element of reliance.

Cases holding that reliance by particular investors need not be shown in a criminal prosecution or in an action brought by the Commission for injunctive relief are inapposite. *SEC v. First American Bank & Trust Co.*, 481 F.2d 673, 680-81 (8th Cir. 1973); *United States v. Amick*, 439 F.2d 351, 366 (7th Cir. 1971); *Farrell v. United States*, 321 F.2d 409, 419 (9th Cir. 1963). *Cf. United States v. Ashdown*, 509 F.2d 793, 799 (5th Cir. 1975). Prosecutions

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[4]On appeal defendants contend for the first time that there is no private right of action under § 17(a). The contention is not properly before us. Wellman v. Jellison, 593 F.2d 876, 879 (9th Cir. 1979); Ralston-Purina Co. v. Bertie, 541 F.2d 1363, 1368 (9th Cir. 1976).

and enforcement actions involve interests and procedures different from those involved in private damage suits. The Government is not "required to prove that anyone was defrauded or that any investor sustained loss," *Farrell, supra,* 321 F.2d at 419, but such proof is essential to recovery by a private investor.

III

Statute of Limitations

The trial court did not err in granting summary judgment on Kramas' claims under § 12(2) of the Securities Act of 1933, 15 U.S.C. §77*l*, and § 25500 of the California Corporations Code, on the ground these claims were barred by the one-year statute of limitations of 15 U.S.C. §77m and Cal. Corp. Code § 25506, respectively.

The limitations period under 15 U.S.C. § 77m does not begin to run until plaintiff discovers the facts constituting the violation or in the exercise of reasonable diligence should have discovered them. *Johns Hopkins University, supra,* 488 F.2d at 917. The same principle applies under Cal. Corp. Code § 338(4), *Turner v. Lundquist,* 377 F.2d 44, 46, 47 (9th Cir. 1967), and, in view of the similarity in language, we think also under Cal. Corp. Code § 25506.

If the running of the statute of limitations depends upon when the plaintiff became aware, or should have become aware, of a fraud, questions of fact are usually involved. *Kubik v. Goldfield,* 479 F.2d 472, 477 & n.12 (3d Cir. 1973). However, reasonable diligence is tested by an objective standard, *Fox v. Kane-Miller Corp.,* 542 F.2d 915, 917 (4th Cir. 1976), and when uncontroverted evidence irrefutably demonstrates plaintiff discovered or should have discovered

the fraudulent conduct, the issue may be resolved by summary judgment. *See Winkelman v. Blyth & Co., Inc.* 518 F.2d 530, 531 (9th Cir. 1975). *See also Cook v. Avien, Inc.*, 573 F.2d 685, 697 (1st Cir. 1978).

This lawsuit was filed in February 1977. To avoid the bar of the statutes of limitations, Kramas must not have discovered the alleged fraud before February 1976. Letters written by Kramas during 1974 and 1975 and excerpts from his deposition testimony demonstrate Kramas knew or should have known of the facts giving rise to his complaint long prior to that date.

In a letter dated July 9, 1974, Kramas complained to SEGO of numerous problems with the drilling projects. He described an earlier project as a "complete disaster," and stated he had received conflicting stories from SEGO management about the status of another project. On October 8, 1975, Kramas wrote fellow limited partners that there was a "serious question" whether SEGO was "merely incompetent, or in fact crooked." Kramas said he had been refused access to the company's books and that SEGO had breached the partnership contract in various ways. He indicated a desire to retain counsel to determine whether a lawsuit should be brought against SEGO, and asked if any of the other investors would be interested in joining. The next day Kramas wrote he had reported SEGO to the SEC and the state Commissioner of Corporations. He said SEGO had committed a flagrant abuse of the law by failing to file the Articles of Partnership. He noted that a geologist he had met had indicated he was bitter about his relationship with Miller and felt he had been "abused by Miller's frequent empty promises." On October 10, 1975,

Kramas sent fellow investors a copy of a newspaper article regarding a suit charging fraud in oil drilling partnerships and asked them to notice "similarities to our complaints against" SEGO and Miller. On November 5, 1975, Kramas wrote other investors that SEGO had "misappropriate[d]" funds, "ripped off" the investors and was engaged in "robbery" in respect to partnership moneys.

Kramas testified on deposition that he entertained "some skepticism" about defendants by July, 1974, and that each time he had conversations with Miller and Rappoport thereafter, "additional elements of doubt c[a]me across." Kramas dep. 173. He testified he had learned that an Indian Creek well was producing a maximum of 30-40 barrels per day, rather than 150 barrels as stated by SEGO. *Id.* at 240. In February 1975, Kramas participated in a meeting with some of the defendants and a fellow investor at which the possibility of criminal fraud on the part of SEGO was discussed. *Id.* at 176-81. Shortly thereafter, Kramas discussed his concerns about SEGO with the SEC. *Id.* at 181-84.

This undisputed evidence was sufficient to establish that Kramas should have known of the allegedly fraudulent conduct upon which he now relies. Kramas argues his continued confidence in the defendants is reflected in evidence that he was "beguiled, patronized and solicited" by SEGO and continued to invest in SEGO projects. But the question is not whether Kramas continued to repose confidence in SEGO but whether in the exercise of reasonable diligence he should have been aware of defendants' allegedly fraudulent conduct. *Fox. v. Kane-Miller Corp., supra,* 542 F.2d

at 917. The evidence relied upon by Kramas was not sufficient to create a factual dispute on that issue.

IV

Other Issues

Kramas argues that defendant SEGO failed to disclose it had received a "free" 5% interest in the DuBois and Saginaw projects and this omission constituted a violation of the securities laws as a matter of law. But Barrons testified that SEGO's interest in the Saginaw project had been disclosed to Kramas, thus presenting an issue of credibility for the jury. SEGO does not contend that its interest in the DuBois project was disclosed, but if the jury believed Barrons' testimony that Kramas was aware of SEGO's 5% interest in Saginaw, yet invested in the Saginaw project anyway, the jury could have concluded that Kramas would not have considered SEGO's similar interest in DuBois to be significant. Thus Barrons' testimony if believed was sufficient to rebut any presumption of reliance on the failure to disclose SEGO's interest in DuBois, and thus to present an issue for the jury.[5]

Kramas argues that false and misleading "Economic Projections" contained in the prospectus for the DuBois and Indian Creek projects were "actionable as a matter of law." Lorenz, defendants' expert witness, testified the economic projections were reasonable. R.T. 513-35. Whether

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[5]The *Affiliated Ute Citizens* presumption of reliance is rebuttable. *See Sharp, supra,* 649 F.2d at 188-89; *Huddleston v. Herman & MacLean,* 640 F.2d 534, 547-48 (5th Cir. 1981). *See generally Note, The Reliance Requirement in Private Actions under SEC Rule 10b-5,* 88 Harv. L. Rev. 584, 597-600 (1975).

they were unreasonable and "false" presented a question of fact. Even assuming the forecasts were unreasonable, the evidence raised a jury question as to whether Kramas relied upon them.

It was not reversible error for the trial court to refuse to admit evidence of a consent decree entered in a prior SEC enforcement proceeding against Miller, SEGO, and other persons offered under Fed. R. Evid. 404(b). The consent decree involved no finding of culpability and no judgment of wrongdoing, and contained a recitation that it did not constitute evidence of wrongdoing in the enforcement proceeding or in any other proceeding. *Cf. Garcia v. Aetna Cas. & Sur. Co.*, 657 F.2d 652, 655 (5th Cir. 1981); *United States v. Herrera-Medina*, 609 F.2d 376, 379 (9th Cir. 1979). Moreover, whether the danger of prejudice from admission of evidence of other wrongful acts—the decree or direct evidence of the alleged wrongful conduct —outweighed its probative value was committed to the trial court's sound discretion. *United States v. Walls*, 577 F.2d 690, 696 (9th Cir. 1978). In this instance the probative value of the evidence was limited—it related to different transactions and alleged misrepresentations of a different kind—while the prejudicial impact of the evidence upon the jury was obviously substantial. Moreover, admission of the evidence would have opened large areas of proof on collateral matters. The district court could reasonably conclude that the balance favored exclusion.

SEGO offered the testimony of a tax accountant regarding the tax benefits that would accrue to an oil well investor with an annual income of $100,000. Kramer objected to the

evidence as not "material or relevant." This objection was properly overruled. It was defendants' position throughout trial that the Kramas investments were motivated by tax considerations, and not by defendants' alleged omissions or misrepresentations, thus negating the element of reliance. We decline to consider the quite different objections to the admissibility of the evidence raised by Kramas for the first time on appeal.

V

The Cross-Appeal

SEGO and the other defendants argue on cross-appeal that California law requires an action for an accounting before one partner may sue another, and Kramas instituted no such action. This contention is made for the first time on this appeal, and we decline to consider it. The defendants also argue there was no rational basis for the jury's award of $3,232 in damages. Defendants failed to move for a new trial, and are therefore precluded from raising this issue on appeal. *Ryen v. Owens,* 446 F.2d 1333, 1334-35 (D.C. Cir. 1971). See 6A J. Moore, *Federal Practice* ¶ 59.15[3] (2d ed. 1979).

The judgment as to plaintiff's Rule 10b-5 and § 17(a) claims must be reversed because of the erroneous instructions on materiality. The judgment dismissing plaintiff's § 12(2) and Cal. Corp. Code § 25500 claims is affirmed. Judgment for plaintiff for breach of fiduciary duty is affirmed.

REVERSED and REMANDED.

Office - Supreme Court, U.S.
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CLERK

No. 81-2409

In the Supreme Court of the United States

OCTOBER TERM, 1981

SECURITY GAS & OIL INC.,
a California corporation,
RAYMOND G. MILLER, EMANUEL RAPOPORT
AND
JAMES BARRONS,
PETITIONERS,

v.

JOSEPH KRAMAS,
RESPONDENT.

RESPONDENT'S BRIEF IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

CHARLES F. BREGA
Counsel of Record
ROATH & BREGA, P.C.
1100 Writers' Center IV
1720 South Bellaire Street
Denver, Colorado, 80222
Telephone (303) 759-5400

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RESPONDENT'S BRIEF IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Respondent Joseph Kramas respectfully requests that this Court deny the Petition for Writ of Certiorari seeking review of the Ninth Circuit's judgment in this case.

Reasons Why The Writ Should Be Denied

I. The Court of Appeals followed the Law as Established by this Court.

II. There is no Conflict among the Circuits Concerning the Definition of Materiality.

III. The Court of Appeals followed Long Established Precedents in Holding that the Kramas Objection was Sufficient to Alert the Court to Error.

I. THE COURT OF APPEALS FOLLOWED THE LAW AS ESTABLISHED BY THIS COURT.

The Court of Appeals properly held that the District Court's instructions in an omission case were erroneous and contrary to this Court's holding in *Affiliated Ute Citizens of Utah* v. *United States*, 406 U.S. 128 (1972). In its instructions to the jury, the District Court stated the following concerning omissions:

> A fact omitted to be stated is the kind of thing that a reasonable person would have changed his mind about had he known the true fact.

Kramas v. *Security Gas & Oil Inc.*, 672 F.2d 766, 768, (9th Cir. 1982).

Three pages later in the transcript after the instructions on materiality, the court instructed the jury on reliance as follows:

> The burden in that case, I would think would be that the plaintiff would show that his decision would have been different had he been made aware of the fact omitted in the presentation.

Id. at 769 n.1.

Plaintiff's counsel objected to the implication in the trial court's instruction. Specifically, counsel noted the following:

> COUNSEL: Your Honor, I would only object to the language stated by the Court concerning the reliance being that it would have dissuaded the plaintiff from investing. I don't believe that to be the law.

> I think, as I understand the law, to be sufficient so that he would have considered it; but that the law does not say, requirement of dissuading him from investing.

Id. at 769.

The Court of Appeals found the instruction erroneous because it implied that the plaintiff must prove reliance upon an alleged omission by showing actual influence upon behavior. The instruction, the Court of Appeals properly noted, was directly contrary to this Court's holding in *Affiliated Ute* wherein this Court specifically stated:

> Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision.

Affiliated Ute Citizens of Utah v. *United States*, 406 U.S. at 153-54.

The Court of Appeals also held that the trial court instruction on materiality, as it related solely to misrepresentations, was wrong and contrary to this Court's holding in *Affiliated Ute* and *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976). In defining a material fact in the case of a misrepresentation, the trial court instructed the jury as follows:

> In the case of the matter stated, is it the sort of thing that, if stated correctly, would have dissuaded the investor from the making the investment [?]

Kramas v. *Security Gas & Oil, Inc.*, 672 F.2d at 768. In *TSC Industries*, however, this Court specifically rejected such an approach:

> The question of materiality, it is universally agreed, is an objective one, involving the significance of an

> omitted or misrepresented fact *to a reasonable investor.* Variation in the formulation of a general test of materiality occurs in the articulation of just how significant a fact must be or, *put another way, how certain it must be that the fact would affect a reasonable investor's judgment.*
>
> ....
>
> As an abstract proposition, the most desirable role for a court in a suit of this sort, coming after the consummation of the proposed transaction, would perhaps be to determine whether in fact the proposal would have been favored by the shareholders and consummated in the absence of any misstatement or omission. But as we recognized in *Mills, supra,* at 382 n.5, 90 S.Ct. at 620, such matters are not subject to determination with certainty.

TSC Industries, Inc. v. *Northway, Inc.*, 426 U.S. at 445 & 448.

(Emphasis added.)

As noted by the Court of Appeals:

> The definition of materiality is the same whether misrepresentations or omissions are involved, and as the Supreme Court said in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449, 96 S. Ct. 2126, 2132, 48 L.Ed.2d 757 (1976), this standard 'does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote.'

Kramas v. *Security Gas & Oil Inc.*, 672 F.2d at 769, quoting from *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 449 (1976). See also *Affiliated Ute Citizens of Utah* v. *United States*, 406 U.S. at 153-54.

It is somewhat difficult to discern Petitioners' argument in requesting this Court to grant certiorari. Petitioners are constantly skipping between reliance and materiality, never clearly distinguishing between the two. For example, Petitioners state:

> The District Court's instruction that *reliance* must be such that an investor would have been dissuaded from making an investment in the case of misrepresentations was entirely in keeping with case law. The Ninth Circuit itself has adhered in 10b-5 cases to the traditional and less speculative common law of the objective test of *materiality*.

Petitioners' Writ at 8 (emphasis supplied). And again, in Petitioners' concluding argument, they state:

> Clearly, then, it is the law among the various circuits, including the Ninth Circuit, that in order for a misrepresentation to be deemed *material*, it must be established that the investor would have acted differently had the facts been truthfully stated. . . . Again, it is another way of saying that *reliance* on the part of the investor is a requirement under Rule 10b-5 in the case of misrepresentations.

Petitioners' Writ at 10 (emphasis supplied).

Petitioners are apparently arguing that materiality and reliance are one and the same element. *Id.* Petitioners' argument stems from a misconception and confusion of the elements of materiality and reliance. Materiality relates to the issue whether a resonable investor would consider the omitted or misstated facts important in making an investment decision. The test is intended to exclude trivial, albeit relevant, facts or facts tangentially related to the fraud, which are therefore unnecessary to a reasonable investor in the formation of the decision to invest. Reliance, on the other hand, is concerned with whether the individual plaintiff believed that the misrepresented statement was true. 5A A. JACOBS, LITIGATION AND PRACTICE UNDER RULE 10b5, §§61.02[a] and 64.01[a] (1982).

What is important to note, however, is that neither the District Court nor the Court of Appeals were ever faced with or addressed the issue whether materiality is equated with reliance in a misrepresentation case. *Kramas* v. *Security Gas & Oil Inc.*, 672 F.2d at 769 n.2. The only reliance issue raised and addressed was whether actual reliance need be established with respect to omissions. Petitioners, however, specifically refused to address that issue. Petitioners' Writ at 8.

II. THERE IS NO CONFLICT AMONG THE CIRCUITS CONCERNING THE DEFINITION OF MATERIALITY.

Petitioners argue, without citing a single case, that "clearly the circuit courts, in the event of misrepresentations, adhere to a requirement that materiality be founded upon the concept that *the investor* would have acted differently had he known the true fact." Petitioners' Writ at 9. As noted, such a result would be contrary to this Court's rule, as established in *TSC Industries* and *Affiliated Ute*, that the facts withheld or misstated be material in the sense that a reasonable investor would have considered them important in making the investment decision. The Ninth Circuit and other circuits addressing the issue subsequent to *TSC Industries* have applied the test as established by this Court. There is no disagreement either between the circuit courts and this Court, or among the circuits. *See SEC* v. *Washington County Utility District*, 676 F.2d 218 (6th Cir. 1982); *SEC* v. *Falstaff Brewing Company*, 629 F.2d 62 (D.C. Cir.), *cert. denied* 449 U.S. 1012 (1980); *Healy* v. *Catalyst Recovery of Pennsylvania, Inc.*, 616 F.2d 641 (3d Cir. 1980); *SEC* v. *Mize*, 615 F.2d 1046 (5th Cir.), *cert. denied* 449 U.S. 901 (1980); *Goodman* v. *Epstein*, 582 F.2d 388 (7th Cir. 1978), *cert. denied* 440 U.S. 939 (1979); *Zweig* v. *Hearst Corp.*, 459 F.2d 1261 (9th Cir. 1979); *Holmes* v. *Bateson*, 583 F.2d 542 (1st Cir. 1978); *St. Louis Union Trust* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 562 F.2d 1040 (8th Cir.), *cert. denied* 435 U.S. 925 (1978); *Hassig* v. *Pearson*, 565 F.2d 644 (10th Cir. 1977); *SEC* v. *Research Automation Corp.*, 585 F.2d 31 (2d Cir. 1973).

III. THE COURT OF APPEALS FOLLOWED LONG ESTABLISHED PRECEDENTS IN HOLDING THAT THE KRAMAS OBJECTION WAS SUFFICIENT TO ALERT THE COURT TO ERROR.

The Court of Appeals followed the other circuits, as Petitioners concede, by adopting and applying a long respected doctrine in its interpretation of Federal Rule of Civil Procedure 51: An objection which alerts the court to error satisfies the rule. *Kramas* v. *Security Gas & Oil Inc.*, 672 F.2d at 769.

As discussed above, the definition of materiality is the same whether misrepresentations or omissions are involved. The District Court in its charge to the jury misstated that definition and Kramas objected to the Court's language concerning whether the omitted or misrepresented facts would have dissuaded the investor from making the investment. Petitioners' argument appears to be that Kramas' objection was not sufficient because it could have related either to the definition of materiality as it relates to an omission or misrepresentation. Petitioners' Writ at 6. As discussed above, however, the law established by this Court is that the test of materiality is the same as to omissions as well as misrepresentations.

It does not help the Petitioners to rely upon *Palmer* v. *Hoffman*, 318 U.S. 108 (1943). In *Hoffman*, the objection related to the burden of proving contributory negligence when two separate causes of action were based on common law and two on statutory law. The trial court in *Hoffman*, without distinguishing between the various causes of action, charged that plaintiff had the burden of proving contributory negligence. The plaintiff objected, generally, to the instruction, without distinguishing the causes of action. The instruction was correct as it related to the statutory cause of action, but not to the common law causes of action. Because the instruction was correct in part, this Court stated that a general objection was not sufficient if a party might have obtained a correct charge by specifically calling attention to the error to the trial court. *Id.* at 119. In short, this Court looked at the issue whether it would be fair to the parties involved to allow a general instruction.

Unlike the *Palmer* case, the instruction given by the District Court in this case with respect to materiality was incorrect as to either omissions or misrepresentations, and Kramas could have said nothing more to convince the trial court to correct the instruction. Thus, the purpose of the Rule, to enable the trial judge to avoid error in his charge, was met and no purpose would have been served by requiring pointless formalities.

CONCLUSION

For the reasons stated, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

October 28, 1982

CHARLES F. BREGA
Counsel of Record
ROATH & BREGA, P.C.
1100 Writers' Center IV
1720 South Bellaire Street
Denver, Colorado, 80222
(303) 759-5400